merger will constitute a default under the Revolving Credit Agreement. The occurrence of a payment default under, or the acceleration of, any indebtedness for borrowed money of TCG in excess of $50 million would be an event of default under the Revolving Credit Agreement. The occurrence of an event of default would allow Toronto Dominion (Texas), Inc., The Chase Manhattan Bank and the Banks to accelerate the maturity of the outstanding advances, call the guarantee of the subsidiaries of TCGNY and foreclose on the collateral.

ETC Facility

ETC, a wholly owned subsidiary of TCG, entered into a credit facility ("the ETC Facility") in October 1995 with CoreStates Bank, N.A. and certain other lenders. The ETC Facility is a $60 million credit facility. Initial borrowings under the ETC Facility of $37 million were principally used to repay existing long-term debt, leases and certain subordinated convertible demand promissory notes. The ETC Facility provides for interest based upon either the base rate, or LIBOR, adjusted as defined in the ETC Facility (7.4375% at December 31, 1997), which is payable quarterly. The balance outstanding is due on September 30, 1998. Borrowings under the ETC Facility are collateralized by substantially all of ETC's assets and outstanding common stock. In addition, the ETC Facility contains certain restrictive covenants which, among other things, require ETC to maintain certain debt service coverage ratios and limit the payment of dividends and capital expenditures. In addition, ETC is required to pay ⅜% per year on the available portion of the ETC Facility. The total outstanding balance at December 31, 1997, was $52.6 million. See "Management's Discussion and Analysis of Financial Condition and Results of Operation of TCG—Liquidity and Capital Resources."

Notes Issued Pursuant to 1996 Offerings

In July 1996 TCG sold $300 million aggregate principal amount of the 1996 Senior Notes and $1,073 million aggregate principal amount at maturity of the 1996 Senior Discount Notes. The 1996 Senior Notes were issued pursuant to an Indenture (the "1996 Senior Notes Indenture") between TCG and United States Trust TCG of New York, as trustee, and the 1996 Senior Discount Notes were issued pursuant to an Indenture (the "1996 Senior Discount Notes Indenture" and, together with the 1996 Senior Notes Indenture, the "1996 Indentures") between TCG and United States Trust Company of New York, as trustee. See "Management's Discussion and Analysis of Financial Conditions and Results of Operations of TCG—Overview."

The 1996 Notes are unsecured obligations of TCG, ranking *pari passu* in right of payment with all senior unsecured indebtedness of TCG. The 1996 Senior Notes bear interest at the rate of 9⅞% per annum payable in cash semiannually on January 1 and July 1 in each year until the principal thereof is paid or duly provided for. The 1996 Senior Discount Notes were issued at a discount to their aggregate principal amount to generate gross proceeds of approximately $625 million. The 1996 Senior Discount Notes accrete at a rate of 11⅛%, compounded semiannually, to an aggregate principal amount of $1,073 million by July 1, 2001. Thereafter, interest on the 1996 Senior Discount Notes will accrue at the rate of 11⅛% per annum and will be payable semiannually on January 1 and July 1, commencing on January 1, 2002; provided that at any time prior to July 1, 2001, TCG may elect to commence the accrual of cash interest on the 1996 Senior Discount Notes, in which case the outstanding principal amount of such 1996 Notes will be reduced to their accreted value as of the date of such election and cash interest shall become payable thereafter. The 1996 Notes are subject to redemption at the option of TCG, in whole or in part, at any time on or after July 1, 2001, initially at 104.938% of their principal amount in the case of the 1996 Senior Notes, and 105.563% in the case of the 1996 Senior Discount Notes and declining to 100% of their principal amount on or after July 1, 2004 in the case of all of the 1996 Notes, in all cases plus accrued and unpaid interest thereon to the applicable redemption date. In addition, in the event of the first to occur prior to July 1, 1999 of a public equity offering with proceeds of $150 million or more or a sale or series of related sales by TCG of its capital stock to certain Strategic Equity Investors (as defined in the 1996 Indentures) for an aggregate purchase price of $150 million or more, TCG may, at its option, within 60 days thereof, use net proceeds of such equity offering to redeem up to one-third of the aggregate principal amount of the 1996 Notes originally issued at a redemption price of 110% of the accreted value as of the redemption date of the 1996 Notes so redeemed; provided that at least one-half of the aggregate principal amount of the 1996 Notes originally issued remains outstanding after such redemption. Upon the occurrence of a Change of

Control (as defined in the 1996 Indentures), each holder of 1996 Notes will have the right to require TCG to purchase all or any part of such holder's 1996 Notes at a purchase price equal to, in the case of the 1996 Senior Discount Notes, 101% of the accreted value thereof in the event of a Change of Control occurring prior to July 1, 2001, plus any accrued and unpaid interest not otherwise included in the accreted value or, in the case of the 1996 Senior Notes and, in the event of a Change of Control occurring on or after July 1, 2001, the 1996 Senior Discount Notes, 101% of the principal amount thereof plus accrued and unpaid interest. The consummation of the AT&T Merger will constitute a Change of Control under the 1996 Indentures.

The 1996 Indentures contain certain restrictive covenants which impose limitations on TCG's and certain of its subsidiaries' ability to, among other things: (i) incur additional indebtedness, (ii) pay dividends or make certain other distributions and investments, (iii) create liens, (iv) create dividend and other payment restrictions on subsidiaries, (v) incur certain guarantees, (vi) enter into certain asset sale transactions, (vii) enter into certain transactions with affiliates (including the Cable Stockholders) and (viii) merge, consolidate or transfer substantially all of TCG's assets.

SELECTED CONSOLIDATED AND COMBINED FINANCIAL DATA OF TCG

The following tables present historical summary combined financial data for the years 1993, 1994 and 1995, derived from the combined audited historical financial statements of TCG and TCG Partners. The selected consolidated financial data set forth below for the years 1996 and 1997 have been derived from the consolidated financial statements of TCG. The financial statements for the years 1995 through 1997 have been audited by Deloitte & Touche LLP, independent auditors, whose report has been included in this Proxy Statement/Prospectus.

The following information should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations of TCG" and the consolidated financial statements of TCG and the combined financial statements of TCG and TCG Partners and the notes thereto included in this Proxy Statement/Prospectus.

	Years Ended December 31,				
	1993	1994	1995	1996	1997
	(dollars in thousands, except share amounts)				
Statements of Operations Data:					
Revenues:					
Telecommunications services	$ 82,374	$ 99,983	$ 134,652	$ 244,864	$ 494,304
Management and royalty fees from local market partnerships(1)	1,555	20,691	31,517	22,805	—
Total revenues	83,929	120,674	166,169	267,669	494,304
Operating expenses	54,218	76,572	93,118	157,591	283,440
Selling, general and administrative(2)	34,281	39,989	50,475	85,025	165,977
In-process research and development costs(3)	—	—	—	—	22,000
Depreciation and amortization	16,197	19,933	37,837	78,416	155,402
Operating (loss)	(20,767)	(15,820)	(15,261)	(53,363)	(132,515)
Interest:					
Interest income	1,072	1,711	4,067	30,219	31,111
Interest expense	(1,407)	(5,079)	(23,331)	(73,633)	(116,172)
Net interest expense	(335)	(3,368)	(19,264)	(43,414)	(85,061)
Minority interest(4)	796	1,395	663	3,520	—
Equity in losses of unconsolidated affiliates	(2,114)	(11,763)	(19,541)	(19,400)	(3,427)
Loss before income taxes	(22,420)	(29,556)	(53,403)	(112,657)	(221,003)
Income tax benefit (provision)	4,149	(433)	(401)	(2,193)	(1,664)
Net (loss)	$ (18,271)	$ (29,989)	$ (53,804)	$ (114,850)	$ (222,667)
Net (loss) per share	$ (0.26)	$ (0.43)	$ (0.77)	$ (1.00)	$ (1.34)
Weighted average number of shares	70,000,140	70,000,140	70,000,140	114,443,695	165,728,059

	1993	1994	1995	1996	1997
	(dollars in thousands, except per share amounts)				
Other Data:					
EBITDA(5)	$ (4,570)	$ 4,113	$ 22,576	$ 25,053	$ 44,887
Cash flows from operating activities	47,438	87,753	36,141	93,618	(21,211)
Cash flows from investing activities	(149,107)	(265,026)	(207,967)	(913,513)	(341,624)
Cash flows from financing activities	129,822	171,557	157,688	1,085,573	258,626
Capital expenditures(6)	155,184	143,276	154,807	308,112	501,035
Ratio of earnings to fixed charges(7)	—	—	—	—	—

	As of December 31,				
	1993	1994	1995	1996	1997
	(dollars in thousands)				
Balance Sheet Data:					
Cash, cash equivalents and marketable securities	$ 31,716	$ 26,000	$ 11,862	$ 718,346	$ 480,159
Working capital	(15,278)	(32,719)	(47,083)	545,325	224,889
Fixed assets—at cost	329,686	422,964	545,653	1,304,229	1,873,083
Total assets	365,202	486,983	614,793	2,050,097	2,456,301
Long-term debt (including capital lease obligations)	29,689	200,462	368,464	1,021,063	1,054,079
Minority interest	12,661	2,903	4,409	—	—
Stockholders' equity and partners' capital (deficit)	209,141	179,152	125,348	796,870	1,031,616

(1) Under the terms of various management services arrangements among TCG and its unconsolidated Local Market Partnerships and certain other affiliates, TCG provided operating and administrative support services to such entities, for which it earned management fees. Upon consummation of the TCG Reorganization, these fees were no longer reflected as revenues.

(2) Included in selling, general and administrative expenses are expenses incurred for services provided to the Local Market Partnerships, in the amounts of $1.4 million, $19.4 million, $29.6 million and $21.4 million for the years 1993, 1994, 1995 and 1996, respectively.

(3) In December 1997, TCG evaluated the acquired assets and liabilities of CERFnet, and as a result of the evaluation, TCG expensed acquired in-process research and development costs.

(4) Minority interest reflects Fidelity Communications Inc.'s equity interest in Teleport Communications Boston for 1993 and 1994; a Cox affiliate's interest in TCG San Diego for 1993 and 1994; and TCI and Continental affiliates' interests in TCG St. Louis for 1994, 1995 and 1996. In 1996, after giving effect to the TCG Reorganization and the debt and equity offerings consummated in June 1996, the minority interest reflects Viacom Telecom, Inc.'s equity interests of 22.2% and 22.9% in TCG Seattle and TCG San Francisco, respectively, and InterMedia Partners' equity interest of 4.2% in TCG San Francisco. In 1997, TCG no longer recorded minority interest for the Local Market Partnerships due to the completion of the TCG Reorganization.

(5) EBITDA consists of earnings (loss) before interest, income taxes, depreciation, amortization, minority interest and equity in losses of unconsolidated affiliates. It is a measure commonly used in the telecommunications industry and is presented to assist in understanding TCG's operating results. EBITDA is not intended to represent cash flows or results of operations in accordance with U.S. GAAP for the periods indicated. TCG's use of EBITDA may not be comparable to similarly titled measures due to the use by other companies of different financial statement components in calculating EBITDA. In 1997, this amount represents Recurring EBITDA which is defined as EBITDA excluding a one-time non-recurring charge for acquired in-process research and development costs.

(6) Capital expenditures for 1996 are net of the effect of the inclusion of the Local Market Partnerships as of June 30, 1996.

(7) The ratio of earnings to fixed charges is computed by dividing pretax income from operations before fixed charges (other than capitalized interest) by fixed charges. Fixed charges consist of interest charges and amortization of debt expense and discount or premium related to indebtedness, whether expensed or capitalized and that portion of rental expense TCG believes to be representative of interest. For the years 1993, 1994, 1995, 1996 and 1997, earnings were insufficient to cover fixed charges by $23.2 million, $31.0 million, $54.1 million, $116.2 million, and $221.0 million, respectively.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS OF TCG

Overview

TCG, the first and largest CLEC in the United States, offers comprehensive telecommunications services in major metropolitan markets nationwide. TCG competes with ILECs by providing high quality, integrated telecommunications services, primarily over fiber optic digital networks, to meet the voice, data and video transmission needs of its customers. TCG's customers are principally telecommunications-intensive businesses, healthcare and educational institutions, governmental agencies, long distance carriers and resellers, Internet service providers, disaster recovery service providers, wireless communications and financial services companies. TCG offers these customers technologically advanced telecommunications services, as well as superior customer service, flexible pricing and vendor and route diversity. During 1997 TCG completed the acquisitions of ETC, now known as TCG Delaware Valley, Inc., CERFnet, now known as TCG CERFnet, Inc., and BizTel. TCG expects to complete the acquisitions of ACC and of KCFN by May 1, 1998 and by August 1, 1998, respectively.

On January 8, 1998, TCG entered into the AT&T Agreement. In the AT&T Merger, each share of TCG Common Stock will be converted into 0.943 of a share of AT&T common stock. The AT&T Agreement contains customary representations and warranties of the parties, which will not survive effectiveness of the AT&T Merger. In addition, the AT&T Agreement contains certain restrictions on the conduct of TCG's business prior to the consummation of the AT&T Merger. Pursuant to the AT&T Agreement, TCG has agreed, for the period prior to the AT&T Merger, to operate its business in the ordinary course, refrain from taking various corporate actions without the consent of AT&T, and not solicit or enter into negotiations or agreements relating to a competing business combination. See "The AT&T Merger".

For over 13 years, TCG has developed, operated and expanded its local telecommunications networks. During the fourth quarter of 1997, TCG added eight new markets, which brings total MSAs served by TCG to 65. These 65 MSAs are in metropolitan New York/New Jersey, Los Angeles, Chicago, San Francisco, Philadelphia, Boston, Detroit, Baltimore, Washington, D.C., Dallas, Houston, Miami/Ft. Lauderdale, Seattle, San Diego, St. Louis, Pittsburgh, Phoenix, Denver, Milwaukee, Indianapolis, Hartford, Omaha, Providence, Cleveland, Portland (Oregon), Salt Lake City, Nashville, Chattanooga, Knoxville, Birmingham, Cincinnati, Columbus (Ohio), Charlotte, Tampa Bay, Sacramento, Minneapolis-St. Paul, Atlanta and Orlando, including 19 of the 20 largest metropolitan areas. As of December 31, 1997, TCG's fiber optic networks spanned over 9,470 route miles, contained over 491,090 fiber miles and served approximately 13,510 buildings.

On July 2, 1996, TCG issued 27,025,000 shares of TCG Class A Common Stock (the "Stock Offering") which resulted in gross proceeds of approximately $432.4 million as part of an initial public offering, $300 million of 9⅞% Senior Notes due 2006 (the "1996 Senior Notes") and $1,073 million aggregate principal amount at maturity of 11⅛% Senior Discount Notes due 2007 (the "1996 Senior Discount Notes" and, together with the 1996 Senior Notes, the "1996 Notes"). Prior to the 1996 Notes offering and the Stock Offering (collectively, the "1996 Offerings"), TCG was owned by subsidiaries of the Cable Stockholders. The business was operated through TCG and, beginning in 1992, TCG Partners, which is a New York general partnership owned prior to the TCG Reorganization by the Cable Stockholders in the same percentages as TCG. TCG Partners was formed to invest, with TCG, the Cable Stockholders and other cable operators, in 14 Local Market Partnerships to develop and operate local telecommunications networks. The Local Market Partnerships were owned by TCG, and/or TCG Partners, certain of the Cable Stockholders which had cable operations in the particular markets addressed by the Local Market Partnerships and, in some cases, other cable operators in such markets. To simplify this complex ownership structure, TCG and the Cable Stockholders completed the TCG Reorganization whereby TCG agreed to consolidate the ownership of TCG Partners and of the Local Market Partnerships as wholly-owned subsidiaries of TCG. As part of this process, certain of the other cable operators agreed to sell their interests in the Local Market Partnerships to TCG directly or through a Cable Stockholder.

See "Business—The TCG Reorganization". The financial statements for one of the Local Market Partnership were previously consolidated with those of TCG. Therefore, as a result of the TCG Reorganization, TC consolidated the financial statements of the remaining 13 of the 14 Local Market Partnerships.

In response to customer demand, TCG plans to increase the geographic reach and density of its existin networks by deploying additional fiber optic rings and connecting additional customers to its networks. The cost associated with the initial installation and expansion of each network, including development, installation, certai organizational costs and early operating expenses, are significant and result in negative cash flow for that marke until an adequate customer base and revenue stream have been established. In addition to capital expenditures TCG begins to incur direct operating costs upon commencement of the installation phase of a network for suc items as salaries and office rent. The exact amounts and timing of these expenditures and costs are subject to variety of factors which may vary greatly by geographic market. As network installation progresses, TCG incur rights-of-way costs, increased sales and marketing expenses (including sales commissions) and, in certai markets, franchise fees and taxes paid to local governments based on revenue. Although TCG's revenues hav increased substantially, TCG's expenses associated with the expansion and development of its loca telecommunications networks have exceeded such revenues. TCG expects its net losses to grow as it continue to expand its networks. However, generally, after the network infrastructure is established, TCG can ad customers and increase revenues with less additional expense. After a customer is added and the volume of suc customer's communications traffic handled by TCG grows, incremental revenues can be added with minima additional expense, providing significant contributions to EBITDA (earnings (loss) before interest, income taxe depreciation, amortization, minority interest and equity in losses of unconsolidated affiliates). For 1997 "Recurring EBITDA" is defined as EBITDA excluding a one-time non-recurring charge for acquired in-proces research and development costs. See "Year Ended December 31, 1997 Compared to Year Ended December 31 1996—EBITDA."

As of December 31, 1997, TCG's consolidated financial statements reflect the results of TCG's wholly owned subsidiaries. The consolidated statements of operations and cash flows include equity in the losses o BizTel for ten months and of ETC for two months. See "The Business of TCG—TCG Recent Developments" Effective as of June 1, 1997, TCG entered into a Technical Services Agreement with KCFN whereby TC agreed to provide certain management services to KCFN. TCG has recorded the results of operations from th date.

For the year ended December 31, 1997, TCG's capital expenditures, its acquisitions and working capit were funded by the 1997 Equity Offering, which raised approximately $328.7 million of aggregate gros proceeds and the 1996 Offerings, which raised approximately $1.3 billion of aggregate gross proceeds.

The development of TCG's business, the construction and expansion of its telecommunications network and its operating expenses require significant expenditures, often resulting in negative cash flow. Although TC generated positive Recurring EBITDA for 1997, several of its subsidiaries did not and will not generate positiv EBITDA until such time as adequate customer bases are established.

Results of Operations

The following table presents historical financial information for 1997 and 1996 and unaudited pro forma financial data for 1996, as if the TCG Reorganization had occurred at the beginning of the year. Pro forma adjustments include the reversal of TCG's equity in losses of 13 Local Market Partnerships for 1996, as well as amortization of the goodwill which was recorded upon closing of the transactions and the reduction of interest expense from the conversion to equity of subordinated debt owed by TCG to the Cable Stockholders. Such information is presented for a more meaningful comparison between 1997 and 1996. The unaudited pro forma financial data does not purport to represent what TCG's results of operations or financial condition would actually have been if the transactions that give the rise to the pro forma adjustments had occurred on the date assumed.

	Years Ended December 31, 1997	Years Ended December 31, 1996	Pro Forma for the TCG Reorganization (5) Year Ended December 31, 1996
	(dollars in thousands, except share amounts)		
Statements of Operations Data:			
Revenues:			
Telecommunications service	$ 494,304	$ 244,864	$ 283,383
Management and royalty fees from Local Market Partnerships(1)	—	22,805	—
Total Revenues	494,304	267,669	283,383
Operating expenses	283,440	157,591	172,374
Selling, general and administrative expenses(2)	165,977	85,025	98,436
In-process research and development costs(3)	22,000	—	—
Depreciation and amortization	155,402	78,416	96,260
Operating loss	(132,515)	(53,363)	(83,687)
Interest:			
Interest income	31,111	30,219	29,163
Interest expense	(116,172)	(73,633)	(66,946)
Net Interest expense	(85,061)	(43,414)	(37,783)
Minority interest(4)	—	3,520	4,713
Equity in losses of unconsolidated affiliates	(3,427)	(19,400)	(7,650)
Loss before income taxes	(221,003)	(112,657)	(124,407)
Income tax provision	(1,664)	(2,193)	(2,193)
Net loss	$ (222,667)	$ (114,850)	$ (126,600)
Net loss per share	$ (1.34)	$ (1.00)	$ (0.86)
Weighted average number of shares	165,728,059	114,443,695	146,423,705

(1) Under the terms of various management services arrangements among TCG and its unconsolidated Local Market Partnerships and certain other affiliates, TCG provided operating and administrative support services to such entities, for which it earned management fees. Upon consummation of the TCG Reorganization, these fees were no longer reflected as revenues.

(2) Included in selling, general, and administrative expenses are expenses incurred for services provided to the Local Market Partnerships, in the amount of $21.4 million, for the year 1996.

(3) In December 1997, TCG evaluated the acquired assets and liabilities of CERFnet, and as a result of the evaluation, TCG expensed acquired in-process research and development costs.

(4) Minority interest reflects TCI and Continental affiliates' interests in TCG St. Louis for 1996. In 1996, after giving effect to the TCG Reorganization and the 1996 Offerings, the minority interest reflects Viacom

Telecom, Inc.'s equity interests of 22.2% and 22.9% in TCG Seattle and TCG San Francisco, respectively, and InterMedia Partners' equity interest of 4.2% in TCG San Francisco. In 1997 TCG no longer recorded minority interest for the Local Market Partnerships due to the completion of the TCG Reorganization.

(5) Pro forma financial information for the year ended December 31, 1996 is as if the TCG Reorganization had occurred at the beginning of the year. Pro forma adjustments include the reversal of TCG's equity in the losses of 13 Local Market Partnerships, as well as amortization of the goodwill which was recorded upon closing of the transactions and the reduction of interest expense from the conversion to equity of subordinated debt owned by TCG to the Cable Stockholders. Such information is presented for a more meaningful comparison between 1997 and 1996.

Year Ended December 31, 1997 Compared to Year Ended December 31, 1996

Revenues

Total revenues increased to $494.3 million for 1997 from $267.7 million for 1996, representing an increase of $226.6 million, or 85%. Pursuant to the TCG Reorganization, TCG consolidated the financial statements of the Local Market Partnerships, which accounted for 17% of total revenue for the year ended December 31, 1997. Telecommunications services revenue increased to $494.3 million for 1997 from $244.9 million for 1996, an increase of $249.4 million, or 102%. Revenues increased in every category, most significantly in switched services. These increases reflect increased sales of services in existing and new markets and the growth of TCG's customer base. Had telecommunications services revenue generated by unconsolidated Local Market Partnerships been included in the consolidated financial statements of TCG for all of 1996, total revenues would have increased to $494.3 million for 1997 from $283.4 million for 1996, on a pro forma basis, an increase of $210.9 million, or 74%. This growth in revenues is a direct result of increased market penetration of all telecommunications services offered in existing markets and the addition of new markets. Total revenues for the year ended December 31, 1997, include $48.1 million attributable to (i) ETC and CERFnet, which were acquired by TCG during the first quarter of 1997, and (ii) BizTel, which was acquired by TCG in the last quarter of 1997. TCG consolidated the financial statements of ETC, CERFnet and BizTel from the dates of acquisition.

Annualized monthly recurring revenue increased to approximately $619.9 million for December 1997 from $329.0 million on a pro forma basis for December 1996, an increase of $290.9 million, or 88%. Monthly recurring revenue represents monthly service charges billable to telecommunications services customers for the month indicated, excluding non-recurring revenues for certain one-time services, such as installation fees or equipment charges.

Switched services revenue increased to $215.2 million for 1997 from $113.0 million on a pro forma basis for 1996, an increase of $102.2 million, or 90%. The increase is due primarily to: increases in switched, local and toll services revenue; long distance carrier access usage volumes; and sales of additional enhanced switched services products to customers in existing and new markets. Dedicated services revenue increased to $252.4 million for 1997 from $161.7 million for 1996, on a pro forma basis, an increase of $90.7 million, or 56%. TCG's data and Internet revenues increased to $22.1 million for 1997 from $1.5 million on a pro forma basis for 1996, an increase of $20.6 million.

Management fees were directly related to operating and administrative support services provided by TCG to the Local Market Partnerships. Royalty fees were charged to the Local Market Partnerships based on revenue. As a result of the TCG Reorganization, management and royalty fees from the Local Market Partnerships were no longer reflected as revenue beginning July 1, 1996, due to the consolidation of the Local Market Partnerships.

Operating Expenses

Operating expenses increased to $283.4 million for 1997 from $157.6 million for 1996, an increase of $125.8 million, or 80%. Pursuant to the TCG Reorganization, TCG consolidated the financial statements of the

Local Market Partnerships, the operating expenses of which accounted for 17% of the total operating expenses for the year ended December 31, 1997. The remaining increases are primarily attributable to costs associated with the expansion of networks throughout the country, including compensation costs for technical personnel, access, bad debt, rent and maintenance expenses. The increase in operating expenses is also attributable to the access and maintenance expenses associated with the growth of switched services in existing markets and the expansion into new markets. Offsetting these expense increases are reductions in expenses due to renegotiation of interconnection agreements with ILECs. Operating expenses increased to $283.4 million for 1997 from $172.4 million on a pro forma basis for 1996, an increase of $111.0 million, or 64%. Operating expenses were approximately 57% and 59% of revenue for the years ended December 31, 1997 and 1996, respectively, and 61% of revenue for the year ended December 31, 1996 on a pro forma basis.

Selling, General and Administrative Expenses

Selling, general and administrative expenses increased to $166.0 million for 1997 from $85.0 million for 1996, an increase of $81.0 million, or 95%. Pursuant to the TCG Reorganization, TCG consolidated the financial statements of the Local Market Partnerships, the selling, general and administrative expenses of which accounted for 23% of the total selling, general and administrative expenses for the year ended December 31, 1997. The remaining increase is a result of the continued expansion of network infrastructure to support continued expansion of TCG's networks, including costs associated with servicing the increased number of dedicated, switched, data and Internet services customers. These costs include expenses related to compensation, including commissions, occupancy, professional fees and various marketing and promotional expenses. Selling, general and administrative expenses increased to $166.0 million for 1997 from $98.4 million, on a pro forma basis, for 1996, an increase of $67.6 million, or 69%. Selling, general and administrative expenses were approximately 34% and 32% of revenue for the year ended December 31, 1997 and 1996, respectively, and 35% of revenue for the year ended December 31, 1996 on a pro forma basis.

EBITDA

TCG recorded a one-time, non-recurring charge of $22 million for certain acquired in-process research and development costs related to the acquisition of CERFnet. For comparison purposes, Recurring EBITDA for 1997 is defined as EBITDA excluding the one-time charge for acquired in-process research and development costs. Recurring EBITDA increased to $44.9 million for 1997 from EBITDA of $25.1 million for 1996, an increase of $19.8 million. The increase in Recurring EBITDA is primarily attributable to increases in dedicated and switched revenues. Recurring EBITDA increased to $44.9 million for 1997 from EBITDA of $12.6 million on a pro forma basis for 1996, an increase of $32.3 million. Comparing 1997 to 1996 on a pro forma basis, TCG has reduced its operating and administrative expenses, as a percentage of revenues, primarily by obtaining lower unit access costs through negotiation of, and participation in, regulatory proceedings relating to various interconnection and reciprocal agreements with ILECs across the country, and by obtaining greater efficiencies through automation.

Depreciation and Amortization Expense

Depreciation and amortization expense increased to $155.4 million for 1997 from $78.4 million for 1996, an increase of $77.0 million, or 98%. This increase is primarily attributable to increased depreciation associated with the expansion of the local telecommunications networks throughout the country and increased amortization of goodwill, FCC licenses and other intangibles related to various 1997 and 1996 acquisitions. Depreciation and amortization expense increased to $155.4 million for 1997 from $96.3 million on a pro forma basis for 1996, an increase of $59.1 million, or 61%.

Interest Income

Interest income increased to $31.1 million for 1997 from $30.2 million for 1996, an increase of $0.9 million. This increase is attributable to an increase in the average outstanding balance of cash and cash equivalents and marketable securities that resulted from the proceeds of the 1996 Offerings and the 1997 Equity Offering.

Interest Expense

Interest expense increased to $116.2 million for 1997 from $73.6 million for 1996, an increase of $42.6 million. This increase resulted from interest on the 1996 Senior Notes, the 1996 Senior Discount Notes and the TCI Subordinated Note. The TCI Subordinated Note was repaid on December 31, 1997, at a discounted value of $25.1 million. In 1996, TCG recorded interest on the Revolving Credit Agreement and borrowings under the loan facility with the Cable Stockholders. Pursuant to the TCG Reorganization, TCG no longer had these debts, and therefore, no interest expense was recorded in 1997. Offsetting this decrease is the interest expense recorded on the bank debt which TCG assumed in the acquisition of ETC.

Equity in Losses of Unconsolidated Affiliates

Equity in losses of unconsolidated affiliates decreased to $3.4 million for 1997 from $19.4 million for 1996, or a decrease of $16.0 million. This decrease resulted primarily from the consolidation of the Local Market Partnerships and ETC.

Income Taxes

In 1997 and 1996, TCG generated net operating losses and, accordingly, incurred a net tax benefit. In accordance with Statement of Financial Accounting Standards ("SFAS") No. 109, "Accounting for Income Taxes," such tax benefit was fully offset, each year, by a valuation allowance. Both the 1997 and 1996 provisions for income taxes resulted from state income taxes where TCG is required to file separate state income tax returns.

At December 31, 1997, TCG had operating loss carry-forwards for tax purposes of approximately $523.0 million, expiring principally in 2003 through 2013. Approximately $49.0 million of the net operating loss carryforward relates to the acquisitions of BizTel and ETC.

Net Loss

TCG's results for 1997 reflected a net loss of $222.7 million, compared to a net loss of $114.9 million for 1996, or an increase of $107.8 million. This increase in net loss is attributable to the factors discussed above. Net loss increased to $222.7 million for 1997 from $126.6 million on a pro forma basis for 1996, or an increase of $96.1 million.

Year Ended December 31, 1996 Compared to Year Ended December 31, 1995

Revenues

Total revenues increased to $267.7 million for 1996 from $166.2 million for 1995, representing an increase of $101.5 million, or 61%. Telecommunications services revenue increased to $244.9 million for 1996 from $134.7 million for 1995, an increase of $110.2 million, or 82%. Revenue increased in every category, most significantly in switched services. These increases reflect increased sales of services in existing and new markets and the growth of TCG's customer base.

During 1996, TCG expanded its dedicated services markets to Salt Lake City, Portland (Oregon), Cleveland and Washington D.C. It also expanded its switched services markets to Indianapolis, Denver, and New Jersey and installed a second switch in its Boston metropolitan serving area. TCG significantly increased revenue from TCG's data services line of business in 1996 by $3.0 million, an increase of 290% from 1995.

On a pro forma basis, had telecommunications services revenue generated by unconsolidated Local Market Partnerships been included in the consolidated financial statements of TCG in 1996 and the combined financial statements of TCG and TCG Partners in 1995, total revenues would have increased to $283.4 million for 1996 from $184.9 million for 1995, an increase of $98.5 million, or 53%. This growth in revenues is a direct result of increased market penetration of all telecommunications services offered in existing markets and the addition of new markets. On a pro forma basis, annualized monthly recurring revenue increased to approximately

$329.0 million for December 1996 from $211.1 million for December 1995, an increase of $117.9 million, or 56%. Monthly recurring revenue represents monthly service charges billable to telecommunications services customers for the month indicated, but excludes non-recurring revenues for certain one-time services, such as installation fees or equipment charges.

On a pro forma basis, switched services revenue increased to $113.0 million for 1996 from $63.9 million for 1995, an increase of $49.1 million, or 77%. The increase is due primarily to: increases in switched, local and toll services revenue; long distance carrier access usage volumes; and sales of additional enhanced switched services products to customers in existing and new markets. On a pro forma basis, dedicated services revenue increased to $161.7 million for 1996 from $116.5 million, which included $1.7 million in data services products for 1995, an increase of $45.2 million, or 39%.

Management and royalty fees from Local Market Partnerships decreased to $22.8 million for 1996, a decrease of $8.7 million, or 28%, from $31.5 million for 1995. Management fees are directly related to operating and administrative support services provided by TCG to the former Local Market Partnerships. The royalty fees were charged to the Local Market Partnerships based on revenue. As a result of the TCG Reorganization, management and royalty fees from the Local Market Partnerships are no longer reflected as revenue beginning July 1, 1996, due to the consolidation of the Local Market Partnerships.

Operating Expenses

Operating expenses increased to $157.6 million for 1996 from $93.1 million for 1995, an increase of $64.5 million, or 69%. This increase is primarily attributable to costs associated with the expansion of networks throughout the country, including technical personnel costs and access, rights-of-way, node, rent and maintenance expenses. The increase in operating expenses is also attributable to the access and maintenance expenses associated with the growth of switched services in existing markets and the expansion into new markets. On a pro forma basis, operating expenses, which included expenses generated by the Local Market Partnerships, increased to $172.4 million for 1996 from $112.6 million for 1995, an increase of $59.8 million, or 53%.

Selling, General and Administrative Expenses

Selling, general and administrative expenses increased to $85.0 million for 1996 from $50.5 million for 1995, an increase of $34.5 million, or 68%. This increase is a result of the continued expansion of network infrastructure to support continued expansion of TCG's networks, including costs associated with servicing the increased number of both dedicated and switched services customers. These costs include expenses related to compensation, occupancy, insurance and professional fees. On a pro forma basis, selling, general and administrative expenses which included expenses generated by the Local Market Partnerships, increased to $98.4 million for 1996 from $71.7 million for 1995, an increase of $26.7 million, or 37%.

EBITDA

EBITDA increased to $25.1 million for 1996 from $22.6 million for 1995, an increase of $2.5 million. This increase is primarily attributable to increases in dedicated and switched revenues. Additionally, on a pro forma basis, TCG has reduced its operating and administrative expenses, as a percentage of revenues, primarily by obtaining lower unit access costs through negotiation of, and participation in, regulatory proceedings relating to various interconnection and reciprocal agreements with ILECs across the country, and by obtaining greater efficiencies through automation. On a pro forma basis, EBITDA increased to $12.6 million for 1996 from $0.6 million for 1995, an increase of $12.0 million. The Local Market Partnerships are included in the pro forma financial data as a result of the TCG Reorganization.

Depreciation and Amortization Expense

Depreciation and amortization expense increased to $78.4 million for 1996 from $37.8 million for 1995, an increase of $40.6 million, or 107%. This increase is primarily attributable to increased depreciation associated with the expansion of the local telecommunications networks throughout the country and increased amortization of goodwill related to various 1996 acquisitions. On a pro forma basis, depreciation and amortization expense, which included depreciation and amortization of the Local Market Partnerships, increased to $96.3 million for 1996 from $62.8 million for 1995, an increase of $33.5 million, or 53%.

Interest Income

Interest income increased to $30.2 million for 1996 from $4.1 million for 1995, an increase of $26.1 million. This increase is attributable to interest earned on the cash and cash equivalents and marketable securities tha resulted from the proceeds of the 1996 Offerings.

Interest Expense

Interest expense increased to $73.6 million for 1996 from $23.3 million for 1995, an increase of $50. million. This increase resulted from interest on TCG's 1996 Senior Notes, the 1996 Senior Discount Notes, an the TCI Subordinated Note, offset by the absence of approximately six months of interest associated with th Revolving Credit Agreement and borrowings under a loan agreement from the Cable Stockholders for the yea ended December 31, 1996.

Equity in Losses of Unconsolidated Affiliates

Equity in losses of unconsolidated affiliates decreased to $19.4 million for 1996 from $19.5 million fo 1995, a decrease of $0.1 million. This decrease resulted from the consolidation of the Local Market Partnership in June 1996, offset by greater losses in 1996 versus 1995.

Income Taxes

In 1996 and 1995, TCG generated net operating losses and, accordingly, incurred a net tax benefit. I accordance with Statement of Financial Accounting Standards ("SFAS") No. 109, "Accounting for Incom Taxes," such tax benefit was fully offset, each year, by a valuation allowance. Both the 1996 and 1995 provision for income taxes resulted from state income taxes where TCG is required to file separate state income tax return

At December 31, 1996, TCG had operating loss carry-forwards for tax purposes of approximately $170. million, expiring principally in 2009 through 2012.

Net Loss

TCG's results for 1996 reflected a net loss of $114.9 million, compared to a net loss of $53.8 million f 1995, an increase of $61.1 million. This increase in net loss is attributable to the factors discussed above. On pro forma basis, net loss increased to $126.6 million for 1996 from $67.6 million for 1995, an increase of $59. million.

Liquidity and Capital Resources

As of December 31, 1997, TCG had total assets of approximately $2.5 billion, an increase of approximatel $400.0 million from $2.1 billion as of December 31, 1996. TCG's current assets of $600.2 million as of Decemb 31, 1997, exceeded current liabilities of $375.3 million, providing working capital of $224.9 million. Netwo and equipment, net of depreciation as of December 31, 1997, aggregated approximately $1.5 billion.

Net cash provided by financing activities for the years ended December 31, 1997 and 1996 was $258 million and $1.1 billion, respectively. Cash flows from financing activities for 1997 consisted primarily proceeds from the 1997 Equity Offering and to a lesser extent from the exercise of employee stock options, and such cash flows were partially offset by the repayment of the TCI Subordinated Note and principal payments on capital leases. Cash flows from financing activities for 1996 consisted primarily of proceeds from the 1996 Offerings and the issuance of long-term debt, partially offset by the repayment of outstanding bank indebtedness and the purchase of treasury stock. Net cash (used in) provided by operating activities was $(21.2) million and $93.6 million for the years ended December 31, 1997 and 1996, respectively. Net cash used for investing activities was $341.6 million and $913.5 million for the years ended December 31, 1997 and 1996, respectively, comprised primarily of capital expenditures and purchases of marketable securities in both years offset by the sale of certain marketable securities and investment in and advances to unconsolidated affiliates in 1996. As of December 31, 1997, cash and cash equivalents were $173.3 million and marketable securities were $306.8 million.

TCG made capital expenditures of $501.0 million and $358.2 million on a pro forma basis for the years ended December 31, 1997 and 1996, respectively. TCG anticipates that capital expenditures (excluding acquisitions) will be in excess of $1.1 billion in the aggregate in 1998, and will primarily be used for the expansion, development and construction of its networks, the acquisition and deployment of switches and the expansion of operating support systems.

Earnings before fixed charges were insufficient to cover fixed charges for the year ended December 31, 1997 and 1996 by $221.0 million and $116.2 million, respectively. On a pro forma basis for the TCG Reorganization, TCG's earnings would have been insufficient to cover fixed charges for the year ended December 31, 1996 by $129.1 million.

TCG has incurred significant net operating losses resulting from the development and operation of new networks which TCG expects will continue as it expands its networks. Persistent demands from TCG's customers for capital intensive local services drives the development, construction and expansion of its networks. While cash provided by operations may be sufficient to fund modest incremental growth it may not be sufficient to fund the extensive expansion and development of networks as currently planned.

Offerings

On July 2, 1996, TCG issued 27,025,000 shares of TCG Class A Common Stock which resulted in gross proceeds of approximately $432.4 million as part of an initial public offering, $300 million of 1996 Senior Notes and $1,073 million aggregate principal amount at maturity of 1996 Senior Discount Notes.

On November 13, 1997, TCG consummated the 1997 Equity Offering. Of the 17,250,000 shares, 7,304,408 shares were offered by TCG (realizing net proceeds of approximately $317.4 million after deducting the underwriting discount and expenses of approximately $11.3 million to TCG) and 9,945,592 shares were offered by Continental Holding Company, a Massachusetts business trust, the shares of which are owned by Continental, which is wholly owned by U S WEST, Inc. Continental acquired its interest in TCG in May 1993. As a result of the consummation of the 1997 Equity Offering, Continental does not hold any shares of TCG Common Stock.

TCG has invested the proceeds from the 1996 Offerings and the 1997 Equity Offering in marketable securities such as Treasury bills, floating rate notes and commercial paper. TCG will utilize the remaining proceeds to expand its networks, for acquisitions and to provide funds for working capital.

Available Credit

Effective as of March 1, 1997, TCG completed its acquisition of ETC. As part of the acquisition, TCG assumed ETC's credit facility with an outstanding amount of $52.6 million. This facility, which ETC entered into in October 1995, is a $60.0 million credit facility (the "ETC Facility") with certain banks. The ETC Facility provides for interest based upon either the base rate, or London Interbank Offered Rate ("LIBOR"), adjusted as defined in the ETC Facility (7.4375% at December 31, 1997), which is payable quarterly. The balanc outstanding is due on September 30, 1998. Borrowings under the ETC Facility are collateralized by substantiall all of the assets and outstanding common stock of TCG Delaware Valley, Inc. In addition, the ETC Facilit contains certain restrictive covenants which, among other things, require TCG Delaware Valley to maintai certain debt service coverage ratios and limit the payment of dividends and capital expenditures. TCG is currentl in compliance with the terms of the covenants. In addition, TCG Delaware Valley is required to pay .375% pe year on the available portion of the ETC Facility. The total outstanding balance at December 31, 1997, was $52. million.

To finance TCG's capital expenditures, acquisitions, investments, working capital and for other genera corporate purposes, TCG's wholly-owned subsidiary, TCG New York, Inc. ("TCGNY"), amended its $25 million Revolving Credit Agreement to a $400 million Revolving Credit Agreement on July 28, 1997. Th Revolving Credit Agreement is secured by (i) the stock of the following TCGNY wholly-owned subsidiaries TC New York Holdings I, Inc., TC New York Holdings II, Inc., TC Systems, Inc., TCG Payphones, Inc. and th partnership interests in Teleport Communications, (ii) a negative pledge on the assets and a pledge of the stoc of each existing and future subsidiary of TCGNY, (iii) a negative pledge on the contracts that relate to TCGN operations, (iv) upstream guarantees from any existing and future subsidiaries of TCGNY and (v) a lien on a present and future intercompany indebtedness owned to TCGNY from TCG and all of its subsidiaries. There i no outstanding balance as of December 31, 1997. As of December 31, 1997, $344.4 million was available t TCG under the Revolving Credit Agreement.

The Revolving Credit Agreement contains various covenants and conditions, including restrictions o additional indebtedness, maintenance of certain financial ratios and limitations on capital expenditures TCG i currently in compliance with the terms of these covenants. None of these covenants negatively impact TCG liquidity or capital resources at this time. In addition, TCG is required to pay .375% per year on the availabl portion of the Revolving Credit Agreement. Unless the banks that are a party to the Revolving Credit Agreeme consent to the AT&T Merger, the consummation of such merger will constitute a default under the Revolvin Credit Agreement.

Future Commitments

TCG has agreed to purchase substantially all of the assets used in connection with the fiber opt communications system of Kansas City Fiber Network, L.P., a CLEC, a majority of the equity of which is owne by TCI and Time Warner Communications. Pending the closing of such transaction, TCG is providing certai services in connection with the operations of such communications system, which is located in the Kansas Cit Missouri/Overland Park, Kansas metropolitan area. The purchase price is approximately $55 million in cash a TCG will be required to assume certain obligations of the seller.

TCG intends to use the net proceeds from the sale of its shares pursuant to the 1997 Equity Offering a the remaining proceeds from the 1996 Offerings to expand and develop existing and new networks and f general corporate and working capital purposes, which may include acquisitions. A significant portion of su proceeds will be contributed or advanced to TCG's subsidiaries which own and operate the networks in the loc markets. Expected capital expenditures for the expansion, development and acquisition of networks and oth telecommunications assets include (i) the purchase and installation of switches, electronics, fiber and oth additional technologies in existing networks and in networks to be constructed in new markets and (ii) t acquisition and expansion of networks and other telecommunications assets currently owned and operated other companies. Expected expenditures for general corporate and working capital purposes include expenditures with respect to TCG's management information systems and corporate service supp infrastructure and (ii) operating and administrative expenses with respect to new networks and debt service.

TCG, to meet its capital requirements in 1998, intends to raise additional capital. TCG will continue to ta advantage of favorable financing arrangements, including the sale of debt or equity securities in the publ markets, private placements, increasing the amount available under the existing credit facilities or addi additional lines of credits. The AT&T Agreement provides that TCG must offer AT&T the right to provide financing which TCG proposes to engage in with third party lenders or other financing sources on the same terms and conditions as TCG could have obtained from such lenders or other sources.

TCG from time to time evaluates acquisitions and investments in light of TCG's long range plans. Such acquisitions and investments, if realized, could use a material portion of TCG's financial resources and may accelerate the need for raising additional capital in the future.

Effects of Recently Issued Accounting Standards

Comprehensive Income—In June 1997, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 130 "Reporting Comprehensive Income." This statement is effective for financial statements issued for periods beginning after December 15, 1997. Management has evaluated the effect on its financial reporting from the adoption of this statement and has found the majority of the disclosures to be not applicable and the remainder to be not significant.

Segments of an Enterprise and Related Information—In June 1997, the FASB also issued SFAS No. 131 "Disclosure about Segments of an Enterprise and Related Information." This statement is effective for fiscal years beginning after December 15, 1997. SFAS No. 131 requires the reporting of profit and loss, specific revenue and expense items, and assets for reportable segments. It also requires the reconciliation of total segment revenues, total segment profit or loss, total segment assets, and other amounts disclosed for segments to the corresponding amounts in the general purpose financial statements. TCG has not yet determined what additional disclosures may be required in connection with adopting SFAS No. 131.

Effects of Inflation

Inflation has not had a significant effect on TCG's operations. However, there can be no assurance that inflation will not have a material effect on TCG's operations in the future.

THE BUSINESS OF ACC

General

ACC is a switch-based provider of telecommunications services in the United States, Canada, the U.K and Germany. ACC primarily provides long distance telecommunications services to a diversified customer base of businesses, residential customers and educational institutions. ACC also provides local telephone service as a switch-based local exchange reseller in upstate New York and Massachusetts and as a reseller of local exchange services in Ontario and Quebec, Canada. ACC entered the German market during 1997 as a switchless reselle of long distance telecommunications services and became a switch-based provider in Germany in February o 1998. ACC operates an advanced telecommunications network, consisting of ten long distance international and domestic switches located in the U.S., Canada, the U.K. and Germany, six local exchange switches located in the U.S., leased transmission lines, IRUs and network management systems designed to optimize traffic routing.

ACC's objective is to grow its telecommunications customer base in its existing markets and to establish itself in deregulating Western European markets that have high density telecommunications traffic when ACC believes that business and regulatory conditions warrant. The key elements of ACC's business strategy are: (1) to broaden ACC's penetration of the U.S., Canadian, U.K. and German telecommunications markets by expanding its long distance, local and other service offerings and geographic reach; (2) to utilize ACC's operating experience as an early entrant in deregulating markets in the U.S., Canada and the U.K. to penetrate other deregulating telecommunications markets that have high density telecommunications traffic; (3) to achieve economies of scale and scope in the utilization of ACC's network; and (4) to seek acquisitions, investments or strategic alliances involving assets or businesses that are complementary to ACC's current operations.

ACC's principal competitive strengths are: (1) ACC's sales and marketing organization and the customized service ACC offers to its customers; (2) ACC's offering of competitive prices, which ACC believes generally are lower than prices charged by the major carriers in each of its markets; (3) ACC's position as an early entrant in the U.S., Canadian and U.K. markets as an alternative carrier; (4) ACC's focus on more profitable international telecommunications traffic between the U.S., Canada and the U.K.; and (5) ACC's switched-based networking capabilities. ACC believes that its ownership of switches reduces its reliance on other carriers and enables ACC to efficiently route telecommunications traffic over multiple leased transmission lines and IRUs and to control costs, call record data and customer information. The availability of existing transmission capacity in its markets makes leasing of transmission lines attractive to ACC and enables it to grow network usage without having to incur the significant capital and operating costs associated with the development and operation of a transmission line infrastructure.

ACC primarily targets business customers with approximately $500 to $15,000 of monthly usage, selected residential customers and colleges and universities. ACC believes that, in addition to being price-driven, these customers tend to be focused on customer service, more likely to rely on a single carrier for their telecommunications needs and less likely to change carriers than larger commercial customers. The diversity of ACC's targeted customer base enhances network utilization by combining business-driven workday traffic with night and weekend off-peak traffic from student and residential customers. ACC strives to be more cost effective, flexible, innovative and responsive to the needs of its customers than the major carriers, which principally focus their direct sales efforts on large commercial accounts and residential customers.

Recent Developments

ACC Management Changes. On December 5, 1997, ACC announced that its Chairman and Chief Executive Officer, David K. Laniak, 62, had died unexpectedly due to health-related complications. As a result, ACC's Board of Directors named Robert M. Van Degna, Chairman of the Board of Directors. Mr. Van Degna has served as an outside director of ACC since 1995. ACC's Board of Directors also established an office of the Chief Executive to jointly perform the functions of Chief Executive Officer, consisting of Christopher Bantoft, Executive Vice President, Michael R. Daley, Executive Vice President and Chief Financial Officer, and Steve M. Dubnik, Executive Vice President.

U.S. WATS Merger. On October 28, 1997, ACC entered into the USW Merger Agreement, by and among ACC, Acquisition Sub, and USW, pursuant to which Acquisition Sub would have merged with and into USW (the "USW Merger"). On March 11, 1998, for reasons beyond the control of both parties which made it impossible to conclude the USW Merger prior to the March 31, 1998 termination date, ACC and USW agreed to a mutual termination of the USW Merger Agreement.

Industry Overview

The global telecommunications industry has dramatically changed during the past several years, beginning in the U.S. with AT&T's divestiture of its RBOCs in 1984 and culminating with the 1996 amendments to the U.S. Communications Act of 1934 (the "U.S. Communications Act"), and continuing in Canada, the U.K. and other countries with various regulatory changes. Previously, the long distance telecommunications industry in the U.S., Canada and the U.K. consisted of one or a few large facilities-based carriers, such as AT&T, Bell Canada and British Telecom. As a result of the AT&T divestiture and the recent legislative changes in the U.S. and fundamental regulatory changes in Canada and the U.K., coupled with technological and network infrastructure developments which increased significantly the voice and data telecommunications transmission capacity of dominant carriers, the long distance industry has developed into a highly competitive one consisting of numerous alternative long distance carriers in each of these countries. In addition, since the AT&T divestiture in 1984, competition has heightened in the local exchange market in the U.S. and Canada. ACC anticipates that deregulatory and economic influences will promote the development of competitive telecommunications markets in other countries.

Long Distance Market. The U.S. long distance market has grown to over $93 billion in annual revenues during 1996, according to FCC estimates. AT&T has remained the largest long distance carrier in the U.S. market, retaining approximately 48% of the market, with MCI and Sprint with respective market shares of approximately 20% and 10% of the market during 1996. AT&T, MCI and Sprint constitute what generally is regarded as the first tier in the U.S. long distance market. Large regional long distance companies, some with national capabilities, such as WorldCom, Inc. (which in 1996 merged with MFS Communications, Inc.), CWI, Frontier Corp., Excel Telecommunications and LCI International, constitute the second tier of the industry, although WorldCom would become a first tier company upon consummation of its pending merger with MCI. The remainder of the U.S. long distance market share is comprised of several hundred smaller companies, including ACC U.S., known as third-tier carriers. In addition, recent U.S. legislation, which removes certain long-standing restrictions on the ability of the RBOCs to provide long distance services, and the World Trade Organization ("WTO") accord on basic services, will have a substantial impact on the long distance market.

Commencing in 1990, competition was introduced in the Canadian long distance market. The Canadian long distance market is dominated by a consortium of facilities-based local and long distance telephone companies (e.g., Bell Canada, BC Tel, Maritime Tel) operating as the "Stentor" group of companies. A second group of long distance providers, consisting principally of AT&T Canada Long Distance Services Company ("AT&T Canada"), Sprint Canada (a subsidiary of Call-Net Telecommunications Inc.) and fONOROLA Inc., own and operate transmission lines through which they provide long distance voice and data services in the Canadian markets. Other long distance providers, including ACC Canada, generally lease transmission lines through which they resell long distance services in the Canadian market.

The international, national and local markets for voice telephone services in the U.K. and Northern Ireland accounted for approximately (Pounds) 1.5 billion, (Pounds) 2.0 billion and (Pounds) 2.2 billion, respectively, in revenues during the 12 months ended March 31, 1997, according to estimates from The Office of Telecommunications ("Oftel"), the U.K. telecommunications regulatory authority. In the U.K., British Telecom historically has dominated the telecommunications market. British Telecom was the largest carrier during such 12 month period, with approximately 58.2%, 78.4% and 88.7% of the revenues from international, national and local voice telephone services, respectively. Cable & Wireless ("CWC") which owns and operates interexchange and local loop transmission facilities, is the second largest carrier of voice telecommunications in the U.K. The remainder of the U.K. long distance market is comprised of an emerging market of licensed public telephone operators, such as Energis Communications Ltd. ("Energis"), WorldCom, ACC U.K. and various cable companies, and switched-based resellers such as First Telecom and Esprit Telecom of the U.K. Ltd. ("Esprit") and Sprint.

Long distance carriers in the U.S., Canada and the U.K. can be categorized by several distinctions. One distinction is between transmission facilities-based companies and non-transmission facilities-based companies, or resellers. Transmission facilities-based carriers, such as AT&T, Bell Canada and British Telecom, own their own long distance interexchange or transmission facilities and originate and terminate calls through local exchange systems. Profitability for transmission facilities-based carriers is dependent not only upon their ability to generate revenues but also upon their ability to manage complex networking and transmission costs. All of the first- and most of the second-tier long distance companies in the U.S. markets are transmission facilities-based carriers and generally offer service nationwide. Most transmission facilities-based carriers in the third tier of the market offer their service only in a limited geographic area. Some transmission facilities-based carriers contract with other transmission facilities-based carriers to provide transmission where they have geographic gaps in their facilities. Carriers that operate primarily as switched-based resellers, such as ACC, carry their long distance traffic over transmission lines leased from transmission facilities-based carriers, originate and terminate calls through incumbent local exchange carriers or CLECs such as TCG and contract with transmission facilities-based carriers to provide transmission of long distance traffic either on a fixed rate lease basis or a call volume basis. Profitability for non-transmission facilities-based carriers is dependent largely on their ability to generate and retain sufficient revenue volume to negotiate attractive pricing with one or more transmission facilities-based carriers.

A second distinction among long distance companies is that of switch-based versus switchless resellers. Switch-based resellers, such as ACC, have one or more switches, which are sophisticated computers that direct telecommunications traffic to form a transmission path between a caller and the recipient of a call. All transmission facilities-based carriers are switch-based carriers, as are many non-transmission facilities-based carriers, including ACC. Switchless resellers, in contrast, depend on one or more transmission facilities-based carriers or switch-based resellers for transmission and switching facilities. ACC believes that its ownership of switches reduces its reliance on other carriers and enables ACC to efficiently route telecommunications traffic over multiple leased transmission lines and to control costs, call record data and customer information. The availability of existing transmission capacity in its markets makes leasing of transmission lines attractive to ACC and enables it to grow network usage without having to incur the significant capital and operating costs associated with the development and operation of a transmission line infrastructure.

Local Exchange Market. In the U.S., the existing structure of the telecommunications industry principally resulted from the AT&T divestiture. As part of the divestiture, seven RBOCs were created to offer services in specified geographic areas called Local Access and Transport Areas ("LATAs"). The RBOCs were separated from the long distance provider, AT&T, resulting in the creation of distinct local exchange and long distance markets. Since the AT&T divestiture, several factors have served to promote competition in the local exchange market, including (i) the local exchange carriers' monopoly position, which provided little incentive for the local exchange companies to reduce prices, improve service or upgrade their networks, and related regulations which required the local exchange carriers to, among other things, lease transmission facilities to alternative carriers, such as ACC, (ii) customer desire for an alternative to the local exchange carriers, which developed in part as a result of competitive activities in the long distance market and increasing demand for lower cost, high quality, reliable services, and (iii) the advancement of fiber optic and digital electronic technology, which combined the ability to transmit voice, data and video at high speeds with increased capacity and reliability.

In Canada, similar factors promoting competition in the local exchange market developed in response to regulatory developments in the Canadian long distance telecommunications market and to technological advances in the telecommunications industry. The Canadian Radio-television and Telecommunications Commission ("CRTC") has approved the introduction of competition in local exchange services in Canada.

Business Strategy

ACC was an early entrant as an alternative carrier in the U.S., Canada and the U.K. ACC's objective is to grow its telecommunications customer base in its existing markets and to establish itself in other deregulating Western European markets with high density telecommunications traffic. The key elements of ACC's business strategy are to increase penetration of existing markets, enter new markets, improve operating efficiency, and pursue acquisitions, investments and strategic alliances.

Increase Penetration of Existing Markets. ACC's consolidated revenue has grown from $126.4 million to $372.6 million over the three fiscal years ended December 31, 1997, although ACC expects its growth to decrease over time. ACC plans to further increase its revenue and customer base in the U.S., Canadian and U.K. markets by expanding its service offerings and geographic reach. The expansion of ACC's service offerings is designed to reduce the effects of price per minute decreases for long distance service and to decrease the likelihood that customers will change telecommunications carriers. Through this strategy, ACC will seek to build a broad base of recurring revenues in the U.S., Canada and the U.K. ACC also offers local telephone services in selected additional U.S. and Canadian markets, including New York, Massachusetts, Quebec and Ontario, as well as additional data communications services in the U.S. and Canada. ACC believes that offering local services will enhance its ability to attract and retain long distance customers and reduce ACC's access charges as a percentage of revenues.

Enter New Markets. ACC believes that its operating experience in deregulating markets in the U.S., Canada and the U.K. and its experience as an early entrant as an alternative carrier in those markets will assist ACC in identifying opportunities in other deregulating countries with high density telecommunications traffic. In particular, ACC believes that its position in the U.S., Canadian and U.K. telecommunications markets and its experience in providing international telecommunications service will assist it in establishing a presence in Western European markets when ACC believes that business and regulatory conditions warrant.

Improve Operating Efficiency. ACC strives to achieve economies of scale and scope in the use of its network, which consists of leased transmission facilities, ten international and domestic switches, six local exchange switches and information systems. In order to enhance the efficiency of the fixed cost elements of its network, ACC seeks to increase its traffic volume and balance business-driven workday traffic with night and weekend off-peak traffic from student and residential customers. ACC anticipates that competition among transmission facilities-based providers of telecommunications services in the U.S. and Canadian markets will afford ACC opportunities for reductions in the cost of leased line facilities. ACC seeks to reduce its network cost per billable minute by more than any reduction in revenue per billable minute. ACC also intends to acquire additional switches and upgrade its existing switches to enhance its network in anticipation of growth in ACC's customer base and provide additional telecommunications services. ACC believes that its network switches enable ACC to efficiently route telecommunications traffic over multiple transmission facilities to reduce costs, control access to customer information and grow network usage without a corresponding increase in support costs.

Pursue Acquisitions, Investments and Strategic Alliances. As ACC expands its service offerings and its network, ACC anticipates that it will seek to develop strategic alliances both domestically and internationally and to acquire assets and businesses or make investments in companies that are complementary to ACC's current operations. ACC believes that the pursuit of an active acquisition strategy is an important means toward achieving growth and economies of scale and scope in its targeted markets. Through acquisitions, ACC believes that it can further increase its traffic volume to further improve the usage of the fixed cost elements of its network.

Services

Commercial Long Distance Services. ACC offers its commercial customers in the U.S. and Canada an array of customized services and has developed a similar range of service offerings for commercial customers in the U.K.

In the U.S., although ACC historically has originated long distance voice services principally in New York and Massachusetts, ACC is currently authorized to originate intrastate long distance voice and data services in 48 states and international voice and data services in all states. ACC's U.S. services include "1+" inter-LATA long distance service, and private line service for which a customer is charged a fixed monthly rate for transmission capacity that is reserved for that customer's traffic. ACC's U.S. business services also include toll-free "800" or "888" services. In addition, ACC currently provides intra-LATA service in certain areas for customers who make a large number of intra-LATA calls. ACC installs automatic dialing equipment to enable customers to place such calls over ACC's network without having to dial an access code. However, various states, including New York, are moving to implement "equal access" for intra-LATA toll calls such that ACC's customers in such jurisdictions will be able to use ACC's network on a "1+" basis to complete intra-LATA toll calls. ACC's ability to compete in the intra-LATA toll market depends upon the margin which exists between the access charges it must pay to the local exchange company for originating and terminating intra-LATA calls, and the retail toll rates established by the local exchange carriers for the local exchange carriers' own intra-LATA toll service. ACC's commercial services generally are priced below the rates charged by the major carriers for similar services and are competitive with those of other carriers.

In Canada, ACC currently originates long distance voice and data services in the Montreal, Toronto and Vancouver metropolitan areas as well as throughout Alberta, British Columbia, Manitoba, New Brunswick, Nova Scotia, Ontario and Quebec. ACC offers its Canadian commercial customers both voice and data telecommunications services. ACC's long distance voice services are offered to its business customers in a nine-level discount structure marketed under the name "Edge." Discounts are based on calling volume and call destination and typically result in savings ranging from 10% to 20% when compared to Stentor member rates. Calls to the U.S. are priced at a flat rate regardless of the destination, and international calls are priced at a percentage discount to the rates charged by the Stentor group. ACC also offers toll-free "800" services within Canada, as well as to and from the U.S., and offers an ACC Travel Card providing substantial savings off Stentor member "Calling Card" rates. ACC Canada has introduced a frame relay network, Internet access services (including Web design/hosting) and paging services, and now provides these services in all provinces except Saskatchewan, Manitoba, New Brunswick and Newfoundland.

ACC originates long distance voice services throughout the U.K. ACC presently offers its U.K. customers voice telecommunications services. These services include indirect access (known as "ACCess 1601") through the public switched telephone network ("PSTN") and the use of direct access lines to ACC's network (known as "ACCess Direct") for higher-volume business users. Because ACCess 1601 is a mass market service, the prices offered are built around a standard price list with volume discounts for high-volume users. ACCess Direct is generally cost effective only for customers making at least (Pounds) 5,000 per month in calls.

ACC's U.S. and Canadian commercial customers are offered customized services, such as comprehensive billing packages and its "Travel Service Elite" domestic calling cards, which allow the customer to place long distance calls at competitive rates from anywhere in the U.S. and Canada. ACC's standard monthly statement includes a management summary report, a call detail report recording every long distance call and facsimile call, and a pricing breakdown by call destination. Optional calling pattern reports, which are available at no extra cost, include call summaries by account code, area or city code, LATA (for U.S. bound calls), international destination and time-of-day. This information is available to customers in the form of hard copy, magnetic tape or disk.

University Program. ACC's university program offers a variety of telecommunications services to educational institutions ranging from long distance service for administration and faculty, to integrated on-campus services, including local and long distance service, voice mail, intercom calling and operator services for students, administrators and faculty. ACC's sales, marketing and engineering professionals work directly with college and university administrators to design and implement integrated solutions for providing and managing telecommunications equipment and services to meet the current and prospective communications needs of their institutions. As part of its program, ACC often installs telecommunications equipment which, depending upon the circumstances, may include a switch or private branch exchange, voice mail, cabling and, in the U.K., pay telephones. Pay phone usage in the U.K., particularly at universities, is more prevalent than in the U.S. and Canada. To access this market directly, ACC has established a pay phone division in the U.K., which supplies pay phones that will automatically route calls from universities and other institutions over ACC U.K.'s network.

ACC's long distance rates in the U.S. for students generally are priced at a 10% discount from those charged by the largest long distance carriers. ACC's university contracts in Canada generally provide it with the exclusive right, and in the U.K. the opportunity, to market to the school's students, faculty and administration. Most of ACC's contracts in Canada also provide for exclusive university support for marketing to alumni. These arrangements allow ACC to market its services to these groups through its affinity programs.

ACC offers university customers in the U.S., Canada and the U.K. certain customized services. ACC offers academic institutions a comprehensive billing package to assist them in reviewing and controlling their telecommunications costs. For its university student customers in the U.S. and Canada, ACC provides a billing format that indicates during each statement period the savings per call (in terms of the discount from the largest long distance carrier's rates) realized during the billing period, and for all university customers ACC provides a call detail report recording every long distance call. In addition, for university student customers, ACC provides individual bills for each user of the same telephone in a dormitory room or suite so that each student in the dormitory room or suite can be billed for the calls he or she made.

Many of ACC's university customers in the U.S. are offered operator services, which are available 24 hours per day, seven days per week. ACC also offers its U.S. university customers its "Travel Service Elite" domestic calling card. In addition, ACC sells a prepaid calling card in the U.S., which allows customers to prepay for a predetermined number of "units" representing long distance minutes. The rate at which the units are used is determined by the destination of the calls made by the customer.

ACC's sales group targets university customers in the U.S., Canada and in the U.K. In the U.S. university market, ACC generally targets small to medium size universities and colleges with full time enrollments in the range of 1,000 to 5,000 students. In Canada, ACC has been able to establish relationships with several large universities. ACC believes that, while its marketing approach in Canada is similar to that in the U.S., its nationwide presence in Canada assists it in marketing to larger academic institutions. In the U.K., ACC has been able to establish long-term relationships with several large universities. ACC believes that, while its marketing approach in the U.K. is similar to that in the U.S., it is able to access larger educational institutions because of its nationwide presence and because transmission facilities-based carriers have not focused on this market. ACC believes that competition in the university market is based on price, as well as the marketing of unique programs and customizing of telecommunications services to the needs of the particular institution and that its ability to adapt to customer needs has enhanced its development of relationships with universities.

Residential Long Distance Services. ACC offers its residential customers in the U.S. and Canada a variety of long distance service plans and is currently offering and developing similar plans for its residential customers in the U.K. In the U.S., ACC's "Save Plus" program provides customers with competitively priced long distance service. In addition, U.S. customers are provided with a "Phone Home" long distance service through which, by dialing an 800 number plus an access code, callers can call home at competitive rates. In general, ACC's residential services are priced below AT&T's premium rates for similar services. In Canada, ACC offers three different residential service programs. The basic offering is a discount plan, with call pricing discounted from the Stentor companies' tariffed rates for similar services depending on the time of day and day of the week. ACC also offers its "Sunset Savings Plan," which allows calling across Canada and to the continental U.S. at a flat rate per minute. In the Toronto metropolitan area, ACC offers "Extended Metro Toronto" calling, which provides flat rate calling within areas adjacent to Toronto that are long distance from each other. Customized billing services are also offered to ACC's U.S. and Canadian residential customers. In the U.K., all residential customers use ACC's ACCess 1601 service, which provides savings off the standard rates charged for residential service by British Telecom or CWC, but requires the customer to dial a four digit access code before dialing the area code and number.

International Long Distance Services. ACC offers international products and services to both its existing customer base and to potential customers in the U.S., Canada and the U.K. ACC's international authorizations ("International Licenses") allow ACC to resell international long distance service on leased international circuits connected to the PSTN at both ends between the U.S. and Canada, the U.S. and the U.K., Canada and the U.K., and, subject to certain safeguards on non-competitive routes and destination country regulations, the U.K. and all other countries and territories, and to own interests in international submarine cable facilities for service between the U.S. and the U.K. and other international points. ACC believes it can compete effectively for international traffic because these international authorizations allow it to offer end-to-end services on certain routes and route traffic efficiently so as to price its services at cost-based rates that are lower than the international settlement-based rates that would otherwise apply to such traffic. However, numerous other carriers also have similar resale licenses. Implementation of the WTO agreement is expected to increase opportunities for alternative call routings but will also increase competition in the industry. Moreover, a recent FCC decision, currently on appeal and subject to petitions for reconsideration, is intended to accelerate reductions in international calling rates and may reduce ACC's margin on international services.

Local Exchange Services. Building on its experience in providing local telephone service to various university customers, ACC took advantage of regulatory developments in New York State and in 1994 began offering local telephone service to commercial customers in upstate New York. As a result of its August 1995 acquisition of Metrowide Communications, ACC provides local telephone service as a reseller in Ontario, Canada, and began providing such service in Quebec in 1996. ACC believes that it can strengthen its relationships with existing commercial, university and college and residential customers in New York State and Canada and can attract new customers by offering them local and long distance services, thereby providing a single source for comprehensive telecommunications services. Providing local telephone service may enable ACC to serve new local exchange customers even if they are already under contract with a different interexchange carrier for long distance service. During 1997, ACC expanded its local telephone operations by installing switches in New York City, Albany and Buffalo, New York, and Boston and Springfield, Massachusetts.

ACC has limited experience in providing local telephone services, having commenced providing such services in 1994. In order to attract local customers, ACC must offer substantial discounts from the prices charged by local exchange carriers and must compete with other alternative local companies that offer such discounts. Larger, better capitalized alternative local providers, including AT&T, among others, will be better able to sustain losses associated with discount pricing and initial investments and expenses. The local telephone service business requires significant initial investments and expenses in capital equipment, as well as significant initial promotional and selling expenses. There can be no assurance that ACC will be able to lease transmission facilities from local exchange carriers at wholesale rates that will allow ACC to compete effectively with the local exchange carriers or other alternative providers or that ACC will generate positive operating margins or attain profitability in its local telephone service business.

Sales and Marketing

ACC markets its services in the U.S., Canada, the U.K. and Germany through a variety of channels, including ACC's internal sales forces, independent sales agents, co-marketing arrangements and affinity programs, as described below. As of December 31, 1997, ACC had a total of approximately 380 internal sales personnel and approximately 580 independent sales agents serving its U.S., Canadian, U.K. and German markets. Although it has not experienced significant turnover in recent periods, a loss of a significant number of independent sales agents could have a material adverse effect on ACC's ability to generate additional revenue. ACC maintains a number of sales offices in the Northeastern U.S., Canada, and the U.K. In addition, with respect to its university and student customers in each country, ACC has designated representatives to assist in customer enrollment, dissemination of marketing information, complaint resolution and, in some cases, collection of customer payments, with representatives located on some campuses. ACC actively seeks new opportunities for business alliances in the form of affinity programs and co-marketing arrangements to provide access to alternative distribution channels.

During each of the last three years, no customer accounted for 10% or more of ACC's total revenue.

United States. ACC markets its services in the U.S. through ACC's internal sales personnel and independent sales agents as well as through attendance and representation at significant trade association meetings and industry conferences of target customer groups. ACC's sales and marketing efforts in the U.S. are targeted primarily at business customers with $500 to $15,000 of monthly usage, selected residential customers and universities and colleges. ACC also markets its services to other resellers and rebillers. ACC plans to leverage its market base in New York and Massachusetts into other New England states and Pennsylvania and to eventually extend its marketing focus to other states. ACC has obtained authorization to originate intrastate long distance voice services in 48 states.

Canada. ACC markets its long distance services in Canada through internal sales personnel and independent sales agents, co-marketing arrangements and affinity programs. ACC focuses its direct selling efforts on medium-sized and large business customers. ACC also markets its services to other resellers and rebillers. ACC uses independent sales agents to target small to medium-sized business and residential customers throughout Canada. These independent sales agents market ACC's services under contracts that generally provide for the payment of commissions based on the revenue generated from new customers obtained by the representative. The use of an independent agent network allows ACC to expand into additional markets without incurring the significant initial costs associated with a direct sales force.

In addition to marketing its residential services in Canada through independent sales agents, ACC has developed several affinity programs designed to attract residential customers within specific target groups, such as clubs, alumni groups and buying groups. The use of affinity programs allows ACC to target groups with a nationwide presence without engaging in costly nationwide advertising campaigns. For example, ACC Canada has established affinity programs with such groups as the Home Service Club of Canada, the University of Toronto and McGill and Western Universities. In addition, ACC has developed a co-marketing arrangement with Hudson's Bay Company (a large Canadian retailer) through which ACC's telecommunications services are marketed under the name "The Bay Long Distance Program" and "Zellers Long Distance."

United Kingdom. In the U.K., ACC markets its services to business and residential customers, as well as other telecommunications resellers, through a multichannel distribution plan including its internal sales force, independent sales agents, co-marketing arrangements and affinity programs.

ACC generally utilizes its internal sales force in the U.K. to target medium and large business customers, a number of which have enough volume to warrant a direct access line to ACC's switch, thereby bypassing the PSTN. ACC markets its services to small and medium-sized businesses through independent sales agents. Telemarketers also are used to market services to small business customers and residential customers and to generate leads for the other members of ACC's internal sales force and independent s les agents. ACC U.K. has established an internal marketing group that is focused on selling its service to other telecommunications resellers in the U.K. and certain European countries on a wholesale basis. ACC U.K. has entered into co-marketing arrangements with utilities, university alumni groups and other organizations.

Network

In the U.S., Canada and the U.K., ACC utilizes a network of lines leased under volume discount contracts with transmission facilities-based carriers, much of which is fiber optic cable. The selection of any particular circuit for the transmission of a call is controlled by routing software, located in the switches, that is designed to cause the most efficient use of ACC's network. ACC evaluates opportunities to install switches in selected markets where the volume of its customer traffic makes such an investment economically viable. Utilization of ACC's switches allows ACC to route customer calls over multiple networks to reduce costs.

Some of ACC's contracts with transmission facilities-based carriers contain underutilization provisions. These provisions require ACC to pay fees to the transmission facilities-based carriers if ACC does not meet minimum periodic usage requirements. ACC has not been assessed any underutilization charges in the past. However, there can be no assurance that such charges would not be assessed in the future. Other resellers generally contract with ACC on a month-to-month basis, select ACC almost exclusively on the basis of price and are likely to terminate their arrangements with ACC if they can obtain better pricing terms elsewhere. ACC uses projected sales to other resellers in evaluating the trade-offs between volume discounts and the minimum utilization rates it negotiates with transmission facilities-based carriers. If sales to other resellers do not meet ACC's projected levels, ACC could incur underutilization charges and be placed at a disadvantage in negotiating future volume discounts.

ACC generally utilizes redundant, highly automated advanced telecommunications equipment in its network and has diverse alternate routes available in cases of component or facility failure. Automatic traffic re-routing enables ACC to provide a high level of reliability for its customers. Computerized automatic network monitoring equipment facilitates fast and accurate analysis and resolution of network problems. ACC provides customer service and support, 24-hour network monitoring, trouble reporting and response, service implementation coordination, billing assistance and problem resolution.

In the U.S., ACC maintains three long distance switches and six local exchange switches. These switches and additional points of presence ("POPs") provide an interface with the PSTN to service ACC's customers. Lines leased from transmission facilities-based carriers link ACC's U.S. points of presence to its switches. ACC U.S. maintains a leased, direct trans-Atlantic link with ACC U.K. that it established in 1994 following ACC's receipt of its U.K. International Simple Resale License for U.K.-U.S. calls and international private line resale authority in the U.S. ACC has purchased an IRU to supplement such trans-Atlantic leased-lines to the U.K. and to enable ACC to reduce network costs.

In Canada, ACC maintains long distance switches in Toronto, Montreal and Vancouver. ACC also maintains frame relay nodes for switched data in Toronto, Montreal, Vancouver and Calgary. ACC uses transmission lines leased from transmission facilities-based carriers to link its Canadian POPs to its switches. This network is also linked with ACC's switches in the U.S. and the U.K. ACC Canada also maintains a leased, direct trans-Atlantic link with ACC U.K. that it established following the grant to ACC U.K. of its ISR License. This transmission line enables ACC Canada to send traffic to the U.K. at rates below those charged by Teleglobe Canada, the exclusive Canadian transmission facilities-based carrier for international calls, other than those to and from the U.S. and Mexico.

In the U.K., ACC maintains long distance switches in London, Manchester and Bristol, England. This network is also linked with ACC's switches in the U.S. and Canada. Customers can access ACC's U.K. network through direct access lines or by dial-up access using auto dialing equipment, indirect access code dialing or least cost routing software integrated in the customer's telephone equipment. In December 1996, ACC U.K. was awarded an International Facilities License, and received a Public Telecommunications Operator license in April 1997, which licenses have enabled ACC to build a microwave network in the U.K. and to begin to use the U.K. as a regional hub for international telecommunications traffic.

In February 1998, ACC installed a long distance switch in Dusseldorf, Germany and commenced offering switch-based long distance service to its customers. In 1997, ACC received a Class 4 full voice telephony license from the German Ministry of Post and Telecommunications, which became effective January 1, 1998, and which is a requirement in order to provide switch-based telecommunications services in Germany.

Network costs are the single largest expense incurred by ACC. ACC strives to control its network costs and its dependence on other carriers by leasing transmission lines on an economical basis. ACC is also considering ownership of certain transmission facilities as a means of reducing its network costs. ACC has purchased IRUs and negotiated leases of private line circuits with carriers that operate fiber optic transmission systems at rates independent of usage, particularly on routes over which ACC carries high volumes of calls such as between the U.S. and Canada and the U.S. and the U.K. ACC attempts to maximize the efficient utilization of its network in the U.S., Canada and the U.K. by marketing to commercial and academic institution customers, who tend to use its services most frequently on weekdays during normal business hours, and residential and student customers, who use these services most often during night and weekend off-peak hours.

Information Systems

ACC believes that maintaining sophisticated and reliable billing and customer services information systems that integrate billing, accounts receivable and customer support is a core capability necessary to record and process the data generated by a telecommunications service provider. While ACC believes its management information system is currently adequate, it has not grown as quickly as ACC's business and substantial investments are needed. ACC is developing and implementing new systems designed to (i) enhance ACC's ability to monitor and respond to the evolving needs of its customers by developing new and customized services, (ii) improve least-cost routing of traffic on ACC's international network, (iii) provide sophisticated billing information that can be tailored to meet the requirements of its customer base, (iv) provide high quality customer service, (v) detect and minimize fraud, (vi) verify payables to suppliers of telecommunications transmission facilities and (vii) integrate additions to its customer base. A variety of problems are often encountered in connection with the implementation of new information systems. There can be no assurance that ACC will not suffer adverse consequences or cost overruns in the implementation of the new information systems or that the new systems will be appropriate for ACC.

Competition

The telecommunications industry is highly competitive and is significantly influenced by the marketing and pricing decisions of the larger industry participants. In each of its markets, ACC competes primarily on the basis of price and also on the basis of customer service and its ability to provide a broad array of telecommunications services. The industry has relatively insignificant barriers to entry, numerous entities competing for the same customers and a high average churn rate, as customers frequently change long distance providers in response to the offering of lower rates or promotional incentives by competitors. Although many of ACC's customers are under multi-year contracts, several of ACC's largest customers (primarily other long distance carriers) are on month-to-month contracts and are particularly price sensitive. Revenues from other resellers accounted for approximately 32%, 4% and 28% of the revenues of ACC U.S., ACC Canada and ACC U.K., respectively, in 1997. With respect to these customers, ACC competes almost exclusively on price and does not have long term contracts. The industry has experienced and will continue to experience rapid regulatory and technological change. Many competitors in each of ACC's markets are significantly larger than ACC, have substantially greater resources than ACC, control transmission lines and larger networks than ACC and have longstanding relationships with ACC's target customers. There can be no assurance that ACC will remain competitive in this environment. Regulatory trends have had, and may have in the future, significant effects on competition in the industry. As ACC expands its geographic coverage, it will encounter increased competition. Moreover, ACC believes that competition in non-U.S. markets is likely to increase and become more like competition in the U.S. markets over time as such non-U.S. markets continue to experience deregulatory influences. See "Legislation and Regulation."

Competition in the long distance industry is based upon pricing, customer service, network quality, value-added services and customer relationships. The success of a non-transmission facilities-based carrier such as ACC depends largely upon the amount of traffic that it can commit to the transmission facilities-based carriers and the resulting volume discounts it can obtain. Subject to contract restrictions and customer brand loyalty, resellers like ACC may competitively bid their traffic among other national long distance carriers to gain improvement in the cost of service. The relationship between resellers and the larger transmission facilities-based carriers is twofold. First, a reseller is a customer of the services provided by the transmission facilities-based carriers, and that customer relationship is predicated primarily upon the pricing strategies of the first tier companies. The reseller and the transmission facilities-based carriers are also competitors. The reseller will attract customers to the extent that its pricing for customers is generally more favorable than the pricing offered the same size customers by larger transmission facilities-based carriers. However, transmission facilities-based carriers have been aggressive in developing discount plans which have had the effect of reducing the rates they